# U.S. House of Representatives
## Committee on Natural Resources
## Washington, DC 20515



June 27, 2011

The Honorable Mary L. Schapiro
Chairman
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Dear Chairman Shapiro:

I am writing in regard to a story which appeared in today's New York *Times*, which reports that a 2008 rules change by the Commission may be contributing to an overestimation in the size of natural gas reserves by publicly traded companies (see Ian Urbina, "S.E.C. Shift Leads to Worries of Overestimation of Reserves," The New York *Times*, June 27, 2001, http://www.nytimes.com/2011/06/27/us/27gasside.html ).

The *Times* report indicates that in 2008, the stocks of many natural gas companies were declining due to the financial meltdown, recession fears, and falling gas prices, but that they began to rebound after a rule change by the Commission allowed the much greater latitude on how they reported their natural gas reserves. Where previously companies were allowed to count gas only from areas close to their active wells as part of their proven reserves, under the new rule companies could now include gas from yet untapped fields based on modeling methods. The article also reports that natural gas companies were not required under the rule to disclose precise details about the technology used to estimate reserve sizes, and that while the Commission considered a requirement for third party audits to verify the new reserve estimates, it did not do so in the final rule.

According to the *Times* article, shale gas producers were the principal beneficiaries of the newly relaxed restrictions and that among 19 of the largest shale gas companies whose financial records were reviewed by the *Times*, at least 7 increased (some by more than 200 percent) the amount of undeveloped reserves reported in their SEC filings after the rule went into effect. In addition, the *Times* reports that the rule change also allowed companies to report lower finding

and development costs, since such costs were now being divided across a much larger reserve estimate. According to the article, 5 of the 7 companies reported huge decreases in finding and development costs – by as much as 86 percent, with the average decrease in such costs for the industry being 48%.

The *Times* article raises concerns about whether this rule change may have allowed some natural gas companies to overstate, perhaps intentionally, the amount of gas they can economically produce. This could, in turn, mislead investors and lenders regarding the true nature of some companies' financial and operating condition and future prospects. While some industry representatives are quoted in the article defending the SEC rules change and subsequent company disclosure practices, other industry insiders are quoted in the Times article as comparing the disclosure practices allowed under the rule to those which took place at Enron prior to its collapse.

This report, if accurate, raises very serious questions about the nature and adequacy of current SEC rules relating to natural gas reserve disclosure and reporting practices. Since such disclosures have an important impact on policy decisions regarding the exploitation and conservation of our nation's natural gas supply, I am writing in my capacity as the Ranking Democrat on the House Natural Resources Committee to request your assistance and cooperation in responding to the following questions regarding the SEC rules:

1. Exactly how did the SEC's 2008 rule regarding modernization of oil and gas reporting change reporting requirements relating to oil and natural gas reserves?

2. Is it true that companies were permitted under the new rule to report reserves based on proprietary modeling, and that the precise details of the technologies being used or the models being applied did not have to be disclosed? If so, are you concerned about the potential for companies to game their models in order to inflate the size of reported reserves?

3. Do you believe that companies should be required to disclosure more information about technologies used to extract gas from unproven reserves, as well as assumptions and methodologies used in any modeling of unproven gas reserves? If not, why not? If so, what action is the SEC taking to require increased disclosure in this area?

4. Is it true that the SEC did not require independent third party audits to verify reserve estimates under the revised rules? If so, why? Are you concerned that the lack of third party verification could allow some companies to provide false or misleading estimates of reserve size or characteristics?

5. Has the SEC undertaken any analysis of the size of the natural gas reserves reported by publicly traded companies since adoption of the revised rules? If so, please provide a copy of such analysis. If not, why has no such analysis been undertaken?

6. While the stated purpose of the SEC rules change was to modernize reporting of oil and natural gas reserves to take account of new technological developments, is the SEC concerned about the possibility that the revised rules might have afforded opportunities for some companies to exaggerate reserve sizes? If so, what action does the SEC plan to take in response?

7. Since adoption of the revised SEC rules regarding reporting of oil and natural gas reserves, has the SEC brought any enforcement actions against registrants for false or misleading disclosures or material misstatements or omissions of fact relating to reporting of oil and natural gas reserves? If so, what is the status of such enforcement actions?

Thank you for your cooperation in responding to this inquiry. Should you have any questions about this request, please contact Mr. Jeff Duncan or Mr. Morgan Gray of the Committee's Democratic Staff at 202-225-6065.

Sincerely,

Edward J. Markey

Edward J. Markey
Ranking Member